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WATER/IRJ

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion To Develop Rules and Procedures to Preserve The Public Interest Integrity Of Government Financed Funding, Including Loans And Grants, To Investor-Owned Water And Sewer Utilities	**FILED** **PUBLIC UTILITIES COMMISSION** **September 2, 2004** **SAN FRANCISCO, CALIFORNIA** **RULEMAKING 04-09-002**

ORDER INSTITUTING RULEMAKING

INTRODUCTION

Government financed funds have been available periodically to California's private investor owned water utilities. To the extent that such financing has been available, it traditionally has been limited to low cost loans. We believe that with the passage of Proposition 50, investor-owned water companies will be eligible for government-financed grants for the first time. Proposition 50, The Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 (Water Code, Division 26.5) was passed by California voters in the November 2002 general election, signed into law in August, 2003 and took effect immediately.

Unlike prior resource bond measures that have restricted grant funds to public and nonprofit organizations, Proposition 50 provides funds for "water systems" or "water projects". The appellate courts repeatedly have held that, while our state Constitution precludes the Legislature from making a gift of public funds to a private person or corporate entity (Section 6 of Article XVI of the California Constitution), as long as the funds are expended for a public purpose and the benefits accrue to the public, the allocation of public funds to private entities is not an unlawful gift. Clearly Proposition 50 promotes a broad public purpose that could be further served by the inclusion of private water companies as fund recipients. The Department of Health Services (DHS), the agency responsible for implementing Proposition 50 fund allocations for

water security, safe drinking water and, in conjunction with the Department of Water Resources (DWR), treatment technology, has issued draft guidelines that include consideration of applications by private investor-owned water utilities. Of the authorized funds in Proposition 50, it appears that private water systems will be eligible to apply for about $1.3 billion in grants and $90 million in loans.

Twenty-six years ago this Commission first developed policies and procedures to govern those situations where publicly furnished capital is employed to provide better service and/or lower rates for customers of privately owned water utilities. Then, the funding source was the California Safe Drinking Water Bond Act (SDWBA) of 1976 and the funding instrument was a low cost government loan. It is appropriate that we review and, where necessary, update the prevailing policies, rules and practices applicable to government financed loans provided to water utilities. Due to the implementation of Proposition 50, it is also appropriate to consider to what extent existing policies, rules and procedures are reasonably applicable or require changes if applied to government funding of utility projects in the form of grants. In both instances the goal is to ensure the proper usage of government financed funds and to preserve the public interest integrity of the products of that special funding. Utilities should not receive a windfall nor should shareholders benefit from grant-funded facilities even if, years later, the utility itself or the individual, grant-funded facility is subsequently leased or sold.

Finally, this Commission also regulates ten sewer utilities that generally come under the regulatory oversight of the Commission's Water Division. While government-financed loans or grants have not yet been extended to privately owned sewer systems, it is appropriate to consider whether the rules and procedures developed in this proceeding would be similarly appropriate if and when such funding becomes available to Commission-regulated sewer utilities. Accordingly, the Commission issues this Order to institute a rulemaking proceeding to develop rules and procedures to preserve the public interest integrity of government financed funding, including loans and grants, provided to investor-owned water and sewer utilities.

HISTORY OF POLICIES RULES AND PRACTICES APPLIED TO UTILITY FACILITIES FINANCED BY GOVERNMENT FUNDS OR BY MEANS OTHER THAN OWNER OR SHAREHOLDER FUNDS

Public Utilities: Return And Ratemaking

United States Supreme Court decisions have clearly established the principle that public utilities are protected by the Fifth and the Fourteenth Amendments to the U. S. Constitution and therefore, are entitled to rates that will provide the opportunity to earn a reasonable return on the property that the utility employs for the convenience of the public.[1] The return should be equivalent to the returns earned in comparable business undertakings with corresponding risks and uncertainties and should be reasonably sufficient, under efficient and economical management, to assure confidence in the financial integrity and creditworthiness of the utility. This return need not be guaranteed or earned, in fact; only the opportunity for earning this reasonable return is required.

The investment in a company, referred to as rate base, is multiplied by the contemporary market-driven rate of return that reflects the cost of capital, both debt and equity, to derive the net earnings that will be incorporated in the rates charged customers for water service. The Commission has reasoned that it is not specific property that has been invested in the public use but rather capital invested in the enterprise and it is that capital upon which the investor has the opportunity to earn a reasonable return. The Commission has authorized utility shareholders the opportunity to earn a reasonable return only on their own investment, not the investment of others. Also, the Commission has allowed a utility to place in rate base only what it paid for a mutual water company it acquired, not the value of the plant, or the original cost of the plant as purchased by the mutual company.

Contributions Excluded From Rate Base

The Commission's policy against allowing utilities to earn on the investment of others is demonstrated in the regulatory treatment of contributions. Most often contributions are advances by developers seeking water service for their newly developed subdivision or they are

[1] See for example, FPC v. Hope natural Gas Co. (1944) 320U.S.591, 64 S.Ct.281; Bluefield Water Works Co. v. Public Service Commission (1923) 262U.S.679; Duquesne Light Co. v Barash (1989) 488U.S.299, 109 S. Ct. 609.

connection fees or facility fees charged to individual customers seeking new water service. The treatment of developer advances or contributions are governed by Water Tariff Rule 15 or the Main Extension Rule, which originally applied to the extended distribution line(s) connecting to the water company. This rule was first developed in 1954 (D. 50580). It provided for refundable advances from prospective customers but expressly required that the financed extension line be excluded from rate base until, and in the precise amount, the advance was actually refunded. Subsequently, the rules authorized receipt of contributions and nonrefundable advances for identifiable facilities. These facilities were a part of utility plant, but consistent with the established policies, were excluded permanently from rate base. More recently, individual Commission decisions and Water Tariff Rule 16 also permit utilities to collect from individual customers a service connection fee to cover the cost of specific service (e.g. private fire protection service) or a facilities fee to represent a proportional cost of additional utility plant that will be required by the new connection. Connection and facilities fees are to be treated as contributions and permanently excluded from the utility's rate base.

By excluding these funds from earning a return the Commission ensures that the utility does not benefit from investments essentially made by others and customers' rates are not increased as a result of this additional investment. These contributions effectively constitute what could be described as a zero cost source of capital.

The Commission Implements The Safe Drinking Water Bond Laws – (four bills 1976-1988)

In June, 1978, Quincy Water Company (Quincy), a class C company with 654 service connections, was the first water utility regulated by the Commission to receive authority to borrow funds and raise rates to repay the government financed loan provided by the SDWBA (Water Code section 13850 et seq.), which had been approved by the voters in June, 1976. (See Quincy Water Company, 84 CPUC 79, D.88973, June 13, 1978.) During the course of the SDWBA and its three successors statutes, more than forty-five Commission-regulated, investor-owned water utilities received nearly thirty million dollars from this government-financed, low

interest loan fund[2]. All but three of the utilities were very small water companies with fewer than 1000 customers.[3]

The SDWBA funded low interest loans for water systems that could not otherwise finance the requisite improvements to satisfy State Health and Safety Code standards. To be eligible for the loan, the water system had to demonstrate its ability to repay the loan and show that it had instituted measures to maximize water conservation. The SDWBA was administered jointly by the DHS, which analyzed the public health issues, and the DWR, which analyzed the need for financial assistance and acted as the lending agency and fiscal administrator. Sections 816 and 851 of the Public Utilities Code required regulated public utilities to obtain the Commission's authorization before they could receive SDWBA loans.

In the Quincy proceeding, the Commission had the benefit of the varied positions of interested parties such as DWR and the California Water Association, an organization of public water utilities, as well as two separate reports presented by Commission staff. In establishing the rate-setting mode for repayment of the loan, the Commission's Quincy decision served as the model for all future SDWBA loan decisions. It identified the conflicting issues and determined the appropriate policies and the regulatory format for treatment of government-financed funding of utility plant.

Although the legislation authorizing SDWBA loans ended sometime ago, low interest loans providing financial assistance to private water companies are still serving a public purpose. The Federal Safe Drinking Water Act was reauthorized in 1996. It created a national safe drinking water loan revolving fund and it specifically included private water utilities as eligible recipients (SRF loans). Today, the California DHS administers this federally supported loan program. Several Commission-regulated utilities have received SRF loans. The Quincy decision and its progeny continue to serve as the applicable policy, practice and procedures governing the implementation of the SRF loans.

[2] In the intervening years, twenty-six of those utilities were sold, 17 to municipal entities and nine to Commission-regulated, class A (over 10,000 customers) water utilities.

[3] They were either Class D (under 500 customers) or class C systems (under 1,000 customers).

While Quincy has served the Commission and the public interest well in the application of procedures and rules to government-financed loans, it is now appropriate for the Commission to consider whether these rules and procedures need revision or updating. There remain some areas for which no policies or guidelines have been developed. For example, now that the facilities constructed with SDWBA funds are near the end of their amortized life, a generic, rather than a case-by-case policy on the proper retirement or disposition of sale proceeds of publicly financed facilities may be appropriate. Further, the application of Commission policies and procedures developed to address publicly funded loans may not provide the appropriate regulatory structure for the treatment of facilities funded by grants.

APPLICATIONS FOR PROPOSITION 50 FUNDS DUE BY YEAR-END

The processing of Proposition 50 applications is imminent. Interested utilities will be required to file with DHS during the preapplication period which will commence at the end of September 2004 and continue until year-end 2004. The funding categories and guidelines, presently in draft form, will be finalized in the coming month. Beginning in October 2004, DHS will conduct workshops for interested water systems in several strategic locations. Attached hereto as Appendix A is a copy of the 15 page DHS Draft General and Specific Criteria for Proposition 50 funding and a two-page document, (identified as pages 16 and 17 of Appendix A) specifying available grant opportunities for small water systems with 1,000 or fewer service connections. When the Guidelines are finalized, they can be viewed on the DHS website: www.dhs.ca.gov/ps/ddwem/

Because of the imminent timeline for Proposition 50 applications, we quickly develop policies and a regulatory structure for implementation of publicly-funded grants: (1) to ensure their proper usage, (2) to provide the appropriate exclusion of such funds and the end product facilities from the rate setting formula, and (3) to preserve the ongoing commitment of the funds and facilities to the public benefit. We anticipate that the first phase will produce an interim decision that will timely provide successful applicant utilities with these requirements at the time DHS issues the first letters of commitment designating the list of conditions, which must be satisfied before a funding agreement is executed. (See page 1, paragraph 7, Appendix A.)

PRELIMINARY SCOPING MEMO

This rulemaking will be conducted in accordance with Article 2.5 of the Commission's Rules of Practice and Procedure. As required by Rule 6(c)(2), this order includes a preliminary scoping memo as set forth below.

The issues to be considered in this proceeding are as follows:

(1) What laws, policies, practices and procedures presently govern the application, usage, ratemaking, retirement and sale of utility facilities financed by government-funded loans?

(2) What laws, policies, practices and procedures presently govern the application, usage, ratemaking, retirement and sale of utility facilities financed by government-funded grants?

(3) What existing policies, practices, rules and/or procedures be updated and/or revised to best insure compliance with existing law and the preservation of the public interest integrity of the utility facilities that are the product of government-financed loans?

(4) What existing policies, practices, rules and/or procedures should be updated and/or revised to best insure compliance with existing law and the preservation of the public interest integrity of the utility facilities that are the product of government-financed grants?

(5) What laws, policies, practices and procedures presently govern the receipt of government funded grants by CPUC-regulated entities generally, and specifically by investor-owned water utilities.

(6) What new policies, practices, rules and/or procedures should be developed that best ensures the proper usage of government funded grants and preserves the public interest purpose of the facilities or studies that those grants produce.

Pursuant to Rule 6(c)(2), we preliminarily determine the category of this rulemaking proceeding to be quasi-legislative as the term is defined in Rule 5(d).

At this time, we do not anticipate holding formal hearings.[4] We need not determine at this time whether to hold hearings to receive testimony regarding adjudicative facts.[5] Any party that believes a hearing is required to receive testimony regarding adjudicative facts must make an explicit request following review of materials produced in response to the descriptive proposed policies and questions listed in Appendix B. Such request should be made in filed comments and must (1) identify the material disputed facts, (2) explain why a hearing must be held, and (3) describe the general nature of the evidence that would be introduced at a hearing. Any right a party may otherwise have to such a hearing will be waived if it does not follow these procedures.

The timetable for this proceeding will depend on the input we receive from the parties. For purposes of addressing the scoping memo requirements, we establish the following tentative schedule, which is subject to change by the assigned Commissioner or the assigned Administrative Law Judge (ALJ):

September 2, 2004	Order Instituting Rulemaking
September 20, 2004	Those interested must file for party status to insure receipt of all filings
October 4, 2004	Comments on Proposed Rules and Response to Questions in Appendix B,
November 5, 2004	Proposed Interim Order
December 6, 2004	Opening Comments –Proposed Interim Order
December 13, 2004	Reply Comments-Proposed Interim Order
December 16, 2004	Interim Order
January 14, 2005	Opening Comments –Identify Remaining Issues

[4] Under Rule 8(f)(2), "'Formal hearing' generally refers to a hearing at which testimony is offered or comments or argument taken on the record... In a quasi-legislative proceeding, 'formal hearing' includes a hearing at which testimony is offered on legislative facts, but does not include a hearing at which testimony is offered on adjudicative facts." And, under Rule 8(f)(3), "'Legislative facts' are the general facts that help the tribunal decide questions of law and policy and discretion."

[5] Rule 8(f)(1): "'Adjudicative facts' answer questions such as who did what, where, when, how, why, with what motive or intent."

Through the scoping memo and subsequent rulings, the assigned Commissioner or the assigned Administrative Law Judge, with the assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding and establish the schedule for remaining events.[6]

In no event do we anticipate this proceeding to require longer than 18 months from issuance of the scoping memo to complete.

Interested parties may file according to schedule, opening comments addressing the components of Appendix B. Responses to questions should be complete and provide a rationale for the response. Comments on Proposed Rules should identify the issues of significance to the party, discuss impact and express whether it is a desirable proposal or not and explain why. Comments should include recommended alternative approaches, and discuss the anticipated impact of the recommended approach. Interested parties will be invited to offer any other suggestions for implementation of new ideas or modification of the policies, practices, rules and procedures governing the receipt and application of government funding and the preservation of the public purpose of the facilities or studies that are the products of those funds that are not now addressed by Appendix B. The opening comments shall follow the requirements of Rule 14.5, Form of Proposals, Comments, and Exceptions. Pursuant to Rule 6(c)(2), parties shall include in their "Opening Comments" any objections they may have regarding (1) the categorization of this proceeding as quasi-legislative, and (2) this preliminary scoping memo.

Following the receipt of opening comments, the assigned Commissioner will issue a ruling that determines the category, need for hearing, scope, and schedule of this rulemaking (Rules 6(c)(2) and 6.3). The ruling, only as to category, may be appealed under the procedures in Rule 6.4.

This proceeding is subject to Rule 7(d) of the Commission's Rules of Practice and Procedures, which specifies standards for engaging in ex parte communications and the reporting of such communications in quasi-legislative proceedings.

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[6] The assigned Commissioner's ruling will establish a schedule for reply comments on the remaining issues, discovery and hearings (if any), the issuance of the Draft Decision on remaining issues, and the corresponding comment period.

Pursuant to Rule 5(k)(3), the assigned Commissioner is the presiding officer in a quasi-legislative proceeding, except that the assigned ALJ shall act as the presiding officer in the Commissioner's absence at any hearing other than a formal hearing as defined in Rule 8(f)(2).

SERVICE LIST

The possible rule development and/or changes to be considered in this Rulemaking could affect all Commission regulated water service and sewer service utilities. The subject matter and issues included in Appendices A and B, may be of interest to the Division of Drinking Water and Environmental Management of the Department of Health Services and to the California Water Association. We will therefore direct that this rulemaking and its appendices be served on all Commission regulated water and sewer service utilities, the Water Branch of the Office of Ratepayer Advocates, as well as Dave Spath, Chief, and Jerri Swoyer, Counsel, for the Division of Drinking Water and Environmental Management of the California Department of Health Services and Sharun Carlson, Executive Secretary, California Water Association.

After initial service, a new proceeding service list will be formed by the Process office, published on the Commission's Internet site and updated throughout the proceeding. The new service list will *not* automatically include the parties who received service of this order. Only water service utilities, sewer service utilities, Water Branch of the Office of Ratepayer Advocates, Dave Spath, Chief, and Jerrie Swoyer, Counsel, of the Division of Drinking Water and Environmental Management of the California Department of Health Services will be included automatically on the new service list. Other interested parties who wish to participate, must request to be added to the new service list by submitting a written request or electronic mail request to the Commission's Process Office, stating their full name, the entity they represent, the postal address and telephone number of the person to be served, an e-mail address if they are willing to be served electronically and their desired service list category (Appearance, State Service, or Information Only). All interested parties must notify the Process Office by September 20, 2004 if they expect to be served all documents. Parties serving documents may rely on the Internet service list published as of the date their documents must be served or may obtain a copy of the service list by calling the Process Office at (415) 703-2021.

We also intend to utilize the electronic service protocols given in Appendix C in this proceeding. Any party requiring paper service of documents in this case should so note that requirement in its request to be added to the service list.

IT IS ORDERED THAT:

1. A rulemaking on the Commission's own motion is instituted to develop and/or update policies, rules, practices and procedures to preserve the public interest integrity of government financed funding, extended to Commission-regulated investor-owned water and sewer utilities, including loans and grants and the products of that funding.
2. This rulemaking is preliminarily determined to be a quasi-legislative proceeding as that term is defined in the Commission's Rules of Practice and Procedure, Rule 5(d).
3. This proceeding is preliminarily determined not to need a formal hearing.
4. The expected timetable for this proceeding is as set forth in the body of this order. The assigned Commissioner by scoping memo and subsequent rulings, and the assigned Administrative Law Judge by ruling with the assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding, provided that in no instance shall this proceeding require longer than 18 months to complete after the coping memo is issued.
5. All Class A and Class B water utilities (utilities with over 2,000 service connections) are respondents. Respondents and Commission's Office of Ratepayer Advocates shall comment on the Proposed Rules and respond to questions contained in the document attached hereto as Appendix B. All other water and sewer utilities and interested parties are invited to respond.
6. Pursuant to Rule 6(c)(2), parties shall include with their opening comments any objections they may have regarding (1) the categorization of this proceeding as quasi-legislative, (2) the determination not to hold hearings, and (3) the preliminary scoping memo.

7. The Executive Director shall mail individual copies of this order to all water and sewer service utilities, the Water Branch, Office of Ratepayer Advocates, Dave Spath, Chief, and Jerri Swoyer, Counsel, of the Division of Drinking Water and Environmental Management of the California Department of Health Services and Sharun Carlson, Executive Secretary, California Water Association. After service of this order, the service list for this proceeding shall be formed following the procedures set forth in the Service List section in the body of this Order Instituting Rulemaking.
8. This order is effective today.

Dated September 2, 2004 at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

APPENDIX B
PART I

1. In Quincy Water Company 84CPUC79, D.88973 (June 13, 1978), the Commission adopted the following policies to govern situations in which there is an opportunity to employ publicly furnished capital to provide better service and/or lower rates for customers of privately owned utilities. Of those policies, should the following be preserved to apply to the regulatory structure governing a water or sewer utility's receipt of publicly funded grants? Please justify or provide a rationale for your response.

A. Any such program is the economic equivalent of a subsidy. All benefits of the subsidy must be flowed through to the customer in the most direct fashion possible, except when there is unequivocal evidence that the legislature intended otherwise.
B. The program should contain checks and balances to ensure that there are no unintended windfalls to the utilities. We should be able to provide assurances that further Commission and/or staff members cannot use the program to provide under-the-table extra benefits to utility managements.
C. Customers have a right to be fully informed as to costs and benefits of projects financed in this matter. They should have at least the same basic information about both original project costs and financing costs as they would about the purchase and financing of a used car. Without such information, it is difficult for consumers to participate intelligently in the decision-making process.

2. Would other or additional policies applicable to the regulatory structure for a water or sewer utility's receipt of publicly funded grants be desirable? List your recommended policies; assume implementation, and comment on the impact expected.

3. The Commission has issued the following Orders authorizing use of publicly funded loans. Should those Orders be preserved in the regulatory structure of implementing publicly funded grants? If, your answer is no, please explain.

A. Plant financed through the publicly funded grants shall be permanently excluded from rate base for ratemaking purposes.
B. The Commission reserves the right to review the manner in which the grant funds are invested and to direct that a different fiscal agent acceptable to the California Department of Health Services be selected if appropriate.
C. All construction financed by publicly funded grants, other than that performed by personnel employed by the recipient water or sewer utility, shall be awarded through competitive bids. No contracts shall be awarded to any affiliated company or person.

(End of Appendix B, Part I)

APPENDIX B
PART II

Consider the Proposed Rules below. Comment on whether each rule should be incorporated in the regulatory structure governing a water or sewer utility's receipt of a publicly funded grant. Please provide a justification or rationale for your response. You may offer an alternative rule or rules to address the issue. Please include your justification or rationale for why the alternate you propose should be adopted.

Proposed Rules:

1) Grant funds cannot be used for operation and maintenance activities.
2) Grant funds and facilities constructed with grant funds shall be excluded from rate base and treated as contributions.
3) Grant funds and facilities constructed with grant funds shall be identified on all financial statements and reports as a separate line item, entitled "Publicly Funded Grants" under the category of Contributions in Aid of Construction. The original grant (or cost of the grant-funded facility) as well as the accumulated amortization for each separately funded grant item shall be shown.
4) The grant funds, excluding those used for land acquisition should be amortized, straight line, over the life of the facilities. No depreciation or amortization shall be expensed for ratemaking purposes or deducted for income tax purposes.
5) Grant funds used to acquire land should not be amortized.
6) Utilities need not have commission pre-approval, prior to applying for a grant.
7) Utilities must seek Commission approval upon receipt of a letter of Commitment from the Department of Health Services and obtain such approval prior to the signing of the funding agreement. The Commission's approval shall confirm the regulatory and ratemaking treatment of the grant.
8) Water utilities may not utilize grant funds for work done prior to the execution of the funding agreement. Similarly, costs incurred after the project application has been accepted but prior to execution of the funding agreement shall not be funded with grant proceeds.
9) If construction or study completion time limits are not established by the funding agency, then the following provisions will control: (1) Construction of the project must start within one year after execution of the funding agreement; (2) The project shall conclude within three years after execution of the funding agreement; (3) Utilities must seek Commission approval for extensions of time limits at least two months prior to the expiration of those limits or risk loss of undelivered funding; and (4) Extension requests may be submitted by advice letter to the Water Division.
10) Utilities shall not gain from the sale of assets, including land, facilities or study products, funded by government grants.

11) Prior to the lease, sale, transfer, or alteration of control, in whole or in part, of the grant-funded land, facilities or product, utilities shall seek explicit Commission authorization for the alienation requested.

12) Alienation, in whole or in part, of all grant-funded land, facilities or products shall retain their public interest integrity or be refunded, in the full amount of the original grant to the funding source.

13) Upon lease, sale, transfer, or alteration of control, in whole or in part, of the grant-funded land, facilities or products, proceeds that exceed the amortized value, shall retain the public interest integrity or be returned in total to the funding source.

14) If grant-funded land, facilities or products is leased, sold, transferred or control altered, in whole or in part, to a Commission-regulated entity, then these rules, in their entirety, shall apply.

15) Proceeds from the lease, sale, transfer or alteration of control, in whole or in part, of the grant-funded land, facilities or products, may be deemed to preserve the public interest integrity of grant funding if reinvested in the utility as a contribution subject to the express approval for the contribution amount and the contribution product by this Commission.

(End of Appendix B, Part II)

APPENDIX B
PART III

Despite the fact that the following questions may appear repetitive of issues enunciated in Appendix B, Part I and Part II, please answer all questions (or expressly refer to your prior applicable comment). Please provide a justification or rationale for your answers.

1) Please suggest any additional rules that you think would be appropriate for grant funding regulation. For each proposed rule, assume implementation and identify the expected impact.

2) DHS criteria and guidelines require matching funds for Proposition 50 grants that are not for disadvantaged communities or small water systems. Identify the various alternative methods available to provide the matching funds. Which do you prefer and why?

3) Should utilities be required to seek a low interest loan to be repaid by customer surcharge, instead of investing shareholder capital, to provide the matching amount?

4) Identify each event or opportunity in the course of employing grant funds at which a utility could obtain a windfall or shareholders a profit. For each of these events or opportunities, advise how the Commission can ensure that the public interest integrity of the grant funds is maintained?

5) What is the appropriate regulatory and/or ratemaking policy to apply to the gain on sale of land and/or property funded in whole or in part by government grants? What about if the funding is from government low-cost loans?

6) What role, if any, should the Commission play in assisting water utilities, in particular small Class C and Class D utilities, in applying for and receiving government funds made available through Proposition 50?

7) If grant funds are provided for the purpose of conducting a study, what provisions should the Commission employ to ensure that the study does not become the intellectual property of the utility and, or its affiliates?

Proceed to the next page and read the hypothetical before answering the questions that follow:

Assume the following:

A water company receives $1 million to renovate its water system. With the $1 million grant, the water company rebuilds half of its water system. Before renovation, the existing system is fully depreciated (therefore this original plant has a value of $0). The $1 million new plant (using grant funds) will have a service life of 20 years and will be amortized accordingly. The water company operates for 10 more years and then sells the whole water system to another water company for $5 million. Of this sales price, $3 million is allocated to the grant funded plant and $2 is allocated to the investors fully depreciated plant.

Please provide detailed explanations for all answers.

When the grant funded plant is originally constructed:

8) How should the $1 million grant money be accounted for by the seller?
   a. Should the plant paid for with grant dollars be treated as Contributions in Aid of Construction (CIAC) for accounting and ratemaking purposes?
   b. If not treated as CIAC, how should the plant paid for with grant dollars be recorded on the books of the company?

9) What level of detailed records should be maintained by the utility for plant paid for with grant funds?
   a. Should sub-accounts in Plant and CIAC be maintained for each grant-funded plant in order to maintain an audit trail?
   b. If sub-accounts are not used, how would an audit trail be maintained in order to track the grant funded plant separate from all other plant owned by the company?

10) Should the construction of plant using grant funds be put out to bid?
   a. If no, explain why not.
   b. If yes, how many bids should be required?

11) Should a utility that builds plant with grant money be required to use a Work Order (WO) System?

12) Should a utility that builds plant with grant money be required to provide progress reports in order to track the disposition of grant fund money?

13) For Class C and D water utilities, if grant funded plant is treated as CIAC, should the company be able earn a return on its operating expenses (operating ratio) instead of rate base?
   a. Should that be the case even though the lack of rate base is entirely or largely due to the fact that facilities were grant funded?

b. If operating ratio is used in the case of item 13 a above, how should the O and M expenses related to the grant funded facility be addressed?

When the grant funded plant is sold:

14) Because the sales price will reflect the fair market value of the grant funded plant, should there be an allocation of the sales price between grant funded plant and investor-funded plant?

a. What method should be used to allocate the sales price between grant funded plant and investor funded plant?

b. How do we preclude buyer and or seller from simply anticipating the allocation and increasing the "fair" market value accordingly, thereby gaining for one or the other a windfall?

15) How do you reconcile the requirement to preserve the public interest integrity of grant-funded plant and implement the Merger Statute (sections 2718 et seq of the Public Utilities Code) as written?

16) Should the buyer of the grant funded plant pay for the grant-funded plant?

a. If the buyer does pay for the grant funded plant, should the dollars paid to the seller for the grant funded plant be repaid to the state when sold?

i. Should the amount repaid to the state be the original amount of the grant?

ii. Should the amount repaid to the state include the interest additive

iii. Should the amount repaid to the state be the net depreciated amount of the grant?

iv. Should the amount repaid to the state be the original amount of the grant and all gain (based on fair market value)?

v. Should the seller be allowed to retain all or a portion of the sales proceeds from the grant funded plant?

17) If there is a gain on sale related to grant funded plant:

a. Should that gain be returned to the state?

b. Should that gain be invested in the Sellers remaining districts?

i. If reinvested in the Sellers public utility, should a rate of return be earned on that plant?

ii. How do you reconcile preservation of the public integrity of grant-funded real property that is deemed no longer used and useful and the option given the utility in section 789 of the Public Utilities Code?

18) How should the buyer record the purchase of grant-funded plant?

a. If grant funded plant dollars are returned to state by seller?

b. If buyer does not pay for grant funded plant?

c. If buyer pays investor funds for grant funded plant?

d. Regardless of how it is paid for, should the grant-funded plant still be booked to CIAC?

19) Should existing ratemaking rules and regulations (in particular section 789 and sections 2718 –2720 of the Public Utilities Code):

a. Be applicable to the sale of grant-funded plant?

b. Be revised to include specific policies that address grant-funded plant?

20) Should an independent, professional appraiser be retained to assess the value of the grant-funded plant separately when a sale is contemplated?

(End of Appendix B, Part III)

APPENDIX C
ELECTRONIC SERVICE PROTOCOLS
(Page 1)

Party Status in Commission Proceedings

These electronic service protocols are applicable to all "appearances, interested parties," And other members of the service list. In accordance with Commission practice, by entering an appearance at a prehearing conference or by other appropriate means, an interested party or protestant gains "party" status. A party to a Commission proceeding has certain rights that non-parties (those in "state service" and "information only" service categories) do not have. For example, a party has the right to participate in evidentiary hearings, file comments on a proposed decision, and appeal a final decision. A party also has the ability to consent to waive or reduce a comment period, and to challenge the assignment of an Administrative Law Judge (ALJ). Non-parties do not have these rights, even though they are included on the service list for the proceeding and receive copies of some or all documents.

Service of Documents by Electronic Mail

For the purposes of this proceeding, all appearances shall serve documents by electronic mail, and in turn, shall accept service by electronic mail.

Usual Commission practice requires appearances to serve documents not only on all other appearances but also on all non-parties in the state service category of the service list. For the purposes of this proceeding, appearances shall serve the information only category electronically as well since electronic service minimizes the financial burden that broader service might otherwise entail.

Filing of Documents

These electronic service protocols govern service of documents only, and do not change the rules regarding the tendering of documents for filing. Documents for filing must be tendered in paper form, as described in Rule 2, *et seq*., of the Commission's Rules of Practice and Procedure. Moreover, all filings shall be served in hard copy (as well as e-mail) on the assigned Commissioner's office and the assigned ALJ. All e-mails shall be sent by 5:00 pm on the due date.

APPENDIX C
ELECTRONIC SERVICE PROTOCOLS
(Page 2)

Electronic Service Standards

As an aid to review of documents served electronically, appearances should follow these procedures:

- Merge into a single electronic file the entire document to be served (*e.g*. title page, table of contents, text, attachments, service list).
- Attach the document file to an electronic note.
- In the subject line of the note, identify the proceeding number; the party sending the document; and the abbreviated title of the document.
- Within the body of the note, identify the word processing program used to create the document. (Commission experience indicates that most recipients can open readily documents sent in Microsoft Word or PDF formats).

If the electronic mail is returned to the sender, or the recipient informs the sender of an inability to open the document, the sender shall immediately arrange for alternative service (paper mail shall be the default, unless another means is mutually agreed upon).

Obtaining Up-to-Date Electronic Mail Addresses

The current service lists for active proceedings are available on the Commission's web page, www.cpuc.ca.gov. To obtain an up-to-date service list of e-mail addresses:

- Choose "Proceedings" then "Service Lists."
- Scroll through the "Index of Service Lists" to the number for this proceeding.
- To view and copy the electronic addresses for a service list, download the comma-delimited file, and copy the column containing the electronic addresses.

The Commission's Process Office periodically updates service lists to correct errors or to make changes at the request of parties and non-parties on the list. Appearances should copy the current service list from the web page (or obtain paper copy from the Process Office) before serving a document.

APPENDIX C
ELECTRONIC SERVICE PROTOCOLS
(Page 3)

Pagination Discrepancies in Documents Served Electronically

Differences among word-processing software can cause pagination differences between documents served electronically and print outs of the original. (If documents are served electronically in PDF format, these differences do not occur.) For the purposes of reference and/or citation in cross-examination and briefing, all parties should use the pagination found in the original document.

(End of Appendix C)